No. 14,760

IN THE

United States Court of Appeals

For the Ninth Circuit

JACK SHOWELL AND DOROTHY SHOWELL,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

REPLY BRIEF FOR PETITIONERS

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PRELIMINARY STATEMENT

The most significant aspect of respondent's brief is its complete silence with respect to several basic points submitted in petitioners' opening brief. For instance, on page 7 of petitioners' opening brief, the contention was advanced that the Tax Court misinterpreted the burden of proof rule when it required petitioners to produce *conclusive* proof of losses instead of a preponderance of the evidence such as would reasonably support a verdict for a plaintiff in an ordinary action for the recovery of money. Respondent's brief does not even dispute the point.

Also, no answer was made to the statement, on pages 12 and 13 of petitioners' brief, that the record was utterly devoid of any evidence to support the Tax Court's findings that petitioner Jack Showell destroyed the individual slips of paper upon which each bet was noted "in order to maintain secrecy respecting his customers and for the purpose of creating an excuse for not producing them if and when called upon."

Nor does respondent reply to the contention, on page 8 of petitioners' opening brief, that the Tax Court cannot find, without substantial evidence or even some evidence to support the finding, that petitioners' record (Exhibit 3) is not reliable while at the same time sustaining deficiency notices based solely on the correctness of that same record (Exhibit 3).

Insofar as respondent's statement of the facts are concerned, certain objections must be registered. First, on page 3 of its brief at the bottom of the page, respondent said:

> "Showell *generally* followed the procedure of reading separately the results of all the winning bets and all of the losing bets to one Houston L. Walsh, a man who shared Showell's office." (Emphasis supplied)

The insertion of the word "generally" is not supported by either the Tax Court's findings of fact or the record. The Tax Court made no reservation when it found that petitioner read to Houston L. Walsh the amounts of all winning and losing bets. Indeed the testimony of Mr. Showell and Mr. Walsh was that the same procedure was *always* used. Petitioners point out this fact because the use of the word "generally" leaves the inference that Mr. Walsh did not always participate in the procedure by which each day's or week's bets were computed and recorded. This is important because Mr. Walsh's testimony that he *always* exchanged places with Mr. Showell and read off the winning and losing tickets to Mr. Showell is vital corroborative testimony that all of Exhibit 3 is accurate (R. 113-115).

Issue is likewise taken with the statement of fact, on page 5 of respondent's brief, that:

"Although Showell retained cancelled checks issued by him in payment to certain winning bettors, he informed the agent, who had requested the names and addresses of persons to whom he had paid winning bets and the amounts of such bets, that he was unable to furnish that information."

Respondent cites the Tax Court's findings of fact as authority, but this begs the question. On page 13 of petitioners' opening brief, issue was taken with such a finding as not being supported by the evidence. In reference to the checks and the names of bettors, Mr. Showell testified as follows on cross-examination:

"Q. Were any of the names you mentioned here, the payees as mentioned, did you disclose any of those names to the Government representative?

A. No.

Q. Why were they not?

A. When Mr. Mende was there, all he asked for was if I could give him all the names, addresses and amount of *every* bet that I paid out and I said that would be impossible and that is as far as it went." (R. 89) (Emphasis Supplied)

With respect to respondent's Summary of Argument, note is taken of its statement that:

"The basic issue presented to the Tax Court was whether the taxpayer's record of bookmaking activities, entitled 'Sports — 1949', accurately listed amounts as net losses incurred on wagers on listed days."

Petitioners submit that the basic issue was whether the taxpayers carried their burden of proof in showing that they did not realize additional income during 1949 as alleged by the deficiency notices. Thus, when respondent's brief says:

"This factual issue turned on the credibility of the record and the testimony by Jack Showell, one of the taxpayers, to the effect that the record accurately contained the results of bookmaking transactions."

it cannot be acquiesced in by petitioners.

ARGUMENT

I

Petitioners agree with respondent's statement, on page 7 of its brief, that the broad issue presented to the Tax Court was whether they realized income exceeding that reported on their returns. However, serious disagreement arises when it is stated by respondent that the determination that petitioners received additional income of $22,563.66 "was made by *utilizing* the taxpayers' only record of bookmaking activities, a summary sheet entitled Sports—1949, which was introduced into evidence as Exhibit 3". "Utilizing" is not the proper word at all. The testimony of the examining revenue agent, H. L. Mende, and the entire record clearly show that Exhibit 3 was the *sole* source and basis of the determination (Pet. Br. 2).

Likewise petitioners cannot agree with respondent's phrase, also on page 7 of its brief, that:

> "The taxpayers did not dispute the accuracy of the 'Gain' amounts shown on the summary sheet, . . . "

Of course the petitioners did not dispute the accuracy of the "Gain" amounts. It was their position that the entire record (Exhibit 3) was accurate, and that the Commissioner could not pick and choose only those entries which were favorable to him while ignoring those entries favorable to the taxpayer unless the evidence showed the unreliability of the entries rejected. To say that the taxpayers did not dispute the accuracy of the "Gain" amounts is no more than an attempt to convince the Court that it was the petitioners who were adopting certain entries when convenient and ignoring others when it was to their advantage. Such was not the case, and the entire record proves that petitioners have always urged that all of Exhibit 3 was correct.

Respondent states, on page 8, that the Tax Court did not give credence to the amounts appearing in the "Loss" column because it did not *believe* that Exhibit 3 was an "honest and faithful record." Petitioners are unable to discover such a statement, direct

or indirect, in the Tax Court's opinion. Nowhere in the opinion is a finding found that Exhibit 3 was not honest and accurate. Indeed such a conclusion would have been impossible to make because the Commissioner's deficiency rested solely on the accuracy of amounts appearing in the "Gain" column of Exhibit 3.

Nor is there agreement with the conclusion, also on page 8, that the Tax Court found that petitioners did sustain some losses in addition to those reflected in the net amounts of gains and,

> "*apparently* on the theory of *Cohan* v. *Commissioner,* 39 F. 2d 540 (C.A. 2d), found such losses to be in the amount of $3,000." (Emphasis supplied)

The word "apparently" cannot avoid the fact that the Tax Court opinion never mentioned *Cohan* v. *Commissioner.* Petitioners submit that defenses on appeal which are based on what the Tax Court "apparently" did should not be seriously considered, but should be evaluated as being indicative of an extremely weak case. Petitioners could not allege as error what the Tax Court "apparently" did. Consequently, defenses should likewise be restricted to reality and conjecture ignored.

On page 9, respondent argues that the Tax Court's findings are *amply* supported by the evidence. This does not answer petitioners' citation, on page 5 of their opening brief, that:

> "A finding of fact is clearly erroneous when, even though there is evidence to support it, the appellate court 'on the entire evidence is left with the definite and firm conviction that a mistake has been committed.' *Gillette's Estate* v. *Commissioner,* 9 Cir. 1950, 182 F. 2d 1010, 1014."

It is also questionable whether respondent's argument that the Tax Court's findings are "amply supported by the evidence" responds to another citation on pages 5 and 6 of petitioners' opening brief that:

> "Should the Tax Court decision lack *substantial* evidence to support it, it will be considered as clearly erroneous and not supported by the evidence. *Wright-Bernet, Inc.* v. *Commissioner,* 6 Cir., 1949, 172 F.2d 343."

If respondent is using the word "amply" to refer to quantity rather than quality, it is no answer. On the other hand, if "amply" is used as a synonym with "substantial", it becomes relevant to examine what is alleged to be the "ample" evidence that supports the Tax Court's decision.

Respondent's list begins on page 9 of its brief at the second paragraph. First, it is said that Mr. Showell's testimony concerning the manner in which Exhibit 3 was prepared and its accuracy was challenged by the Commissioner on cross-examination and rejected by the Tax Court as self-serving. To begin with, Mr. Showell's testimony on cross-examination with respect to the manner of preparation and accuracy of Exhibit 3 was not challenged. Instead, his testimony was strengthened. Furthermore, how could the Commissioner have challenged the manner of preparation and accuracy of Exhibit 3 when he was relying on the accuracy of the "Gain" column therein as the sole basis of his deficiencies? In addition, what is the signficance of an argument that a taxpayer's testimony was challenged by the Commissioner on cross-examination? It usually is. The question is whether it was believed, and the Tax Court made no finding in that regard, and for good reason. Virtually all of the Tax Court's findings of fact are based on Mr. Showell's testimony including all of the findings of fact concerning Exhibit 3, except the ultimate finding concerning the "Loss" column. Respondent cannot escape from this fact by its attempt to create a distinction between the testimony Mr. Showell gave concerning the "general manner in which his bookmaking business was conducted" and "the manner in which the summary sheet entitled 'Sports—1949' (Exhibit 3) was prepared and its accuracy." (Res. Br. 9). The distinction does not exist in fact, and if it did, it would be impossible of detection.

Next, respondent cites, on pages 9 and 10, as substantial evidence supporting the Tax Court's findings, that although Mr. Showell had checks showing amounts paid to bettors he did not make them available to the revenue agent who requested Mr. Showell to turn over to him "any proof substantiating the claim

that the losses had been incurred." The pages of the record cited by respondent (R. 55, 56) reflect that Mr. Mende asked Mr. Showell for detailed records on the daily and weekly totals, but was not asking for or interested in the checks because as Mr. Mende himself testified:

> "The cancelled checks would not have any bearing on it." (R. 50).

The reason, of course, was that retained cancelled checks to certain bettors were not relevant because a check payment to a bettor had no relation to the amount the individual either won or lost because as Mr. Showell testified:

> ". . . some of these people put up their money to start with. I may have given them a check and still show a loss. The check may have been less than they sent in, that is, the amount of the checks." (R. 74, 75).

But, more important, what is the relevance between the production of these cancelled checks, which were never asked for (R. 50, 61), and respondent's contention that the Tax Court's findings are supported by substantial evidence? Petitioners submit that there is none.

Next, and in the same paragraph, respondent says:

> "Moreover, Mr. Showell testified that he never furnished any of the names and addresses of bettors on whose bets he had incurred losses to the revenue agent, although such names were requested, *presumably* because the agent had asked for all of the names of such persons and Showell would have only been able to furnish some names." (Emphasis supplied)

To be accurate Mr. Showell was not asked to produce just the names. As he testified:

> "A. When Mr. Mende was there, all he asked for was if I could give him *all* the *names, addresses* and *amount of every bet* that I paid out and I said that would be impossible and that is as far as it went." (R. 89) (Emphasis supplied)

Because the cancelled checks had no relationship to losing bets, date of bet, or total amount of bets won or lost, it was impossible

for him to give Mr. Mende the information the latter sought. Furthermore, does the fact that this material could not be obtained offer substantial evidence to support the Tax Court's findings? Respondent argues that it does because without all of the names, addresses, and amounts of every bet, the Commissioner could not check the accuracy of the statements appearing on Exhibit 3. But what does such an argument say except that it was impossible for petitioners to carry their burden of proof as to Exhibit 3 even though the Commissioner's deficiencies were based on it. The problem before the Tax Court was whether petitioners carried their burden of proof in court, and was not whether the revenue agent's request for all of the names, addresses, and amounts should have been interpreted by Mr. Showell to mean just some of the names, addresses and amounts, whatever good that would have done.

To say that the above factors, coupled with the fact that Mr. Showell was a "highly interested witness" (Res. Br. 10), are sufficient reason for the Tax Court to refuse to believe his testimony "on this crucial issue" is not relevant. What crucial issue? Also, where did the Tax Court state that it did not believe Mr. Showell? It merely classified his testimony as "self-serving", the sufficiency of which petitioners challenged on pages 9 and 10 of their opening brief, and which cannot be successfully avoided by exchanging the words "highly interested" for "self-serving". Petitioners submit that respondent's argument does not offer substantial evidence to support the Tax Court's finding.

Furthermore, the accuracy of Exhibit 3 cannot be challenged by arguments tucked away in footnotes of respondent's brief such as the following on page 10:

> "The Tax Court *might* also have wondered about the *apparent* inconsistency between Mr. Showell's testimony that he took bets on basketball games (R. 59, 60, 91, 100), and his testimony that he did not take bets between January and September (R. 91) *apparently* to corroborate the lack of any gains or losses on Exhibit 3 for that period, while the basketball season extends through February." (Emphasis supplied)

This is a remarkable argument. It is based on an assumption that the Tax Court "might" have wondered. It is not based on anything in the record. It is based on an "apparent" inconsistency, and attempts to infer that Mr. Showell testified he took bets on all basketball games. It is based on an assumption that the Tax Court "might" have wondered about an "apparent inconsistency" arising from testimony "apparently" given to corroborate no entries for January to February. About the only fact in the footnote is that the basketball season extends through February, and even that is not in the record. Unquestionably the trial court itself would not consider so many consecutive non-sequitors. Their presence in a brief to this Court can only indicate that grasping for straws was essential.

As further support for the conclusion that the Tax Court's findings are based on substantial evidence, it was said, on page 10, with respect to the corroborative testimony of Houston L. Walsh that:

> "His testimony was confusing[5] and taken most favorably to the taxpayers tends to prove only that there were slips showing each bet which were used in preparing the summary sheet."

The authority for the statement that Mr. Walsh's testimony was confusing is another footnote argument which states:

> "[5] The transcript does not make it clear whether Mr. Walsh actually saw the figures on each of the betting slips."

This is a strange footnote to use as support of the statement that Mr. Walsh's testimony was confusing in view of respondent's own statement of the facts on page 4 of its brief that:

> "A similar procedure was followed with Walsh reading from the slips and sheets and Showell using the adding machine."

Also, the Tax Court so found (R. 14), and the testimony shows that Mr. Walsh and Mr. Showell *always* exchanged places so that Mr. Walsh too *always* read from the slips and sheets to Mr. Showell who added the amounts on an adding machine (R. 110-115, 14, 15). Thus, it is quite clear that Mr. Walsh actually saw the figures on the slips, and that respondent does not seriously

offer the point in view of its own statement of the facts.

When respondent says that Mr. Walsh's testimony only proves there were slips for each bet, but that he could not vouch for their accuracy, it is simply repeating the Tax Court's statement which was questioned on pages 11 and 12 of petitioners' opening brief. However, the repetition of the statement does not offer any answer. Consequently, petitioners urge that no substantial evidence to support the Tax Court's findings has been presented by the Walsh contentions.

Following the Walsh contentions, respondent "disposes" of Mr. Leech's corroborative testimony that at the end of 1949 he owed Showell $1,350 by saying:

> "Since, however, the Tax Court found that the taxpayers sustained additional losses of $3,000, *it must be assumed* that this testimony was taken into account in making that finding." (Emphasis supplied)

Why must it be assumed? The Tax Court opinion does not even contain Mr. Leech's name in it. What is the logical relationship between a round sum of $3,000 and $1,350 which requires the adoption of an "assumption" that the former comprehended the latter, particularly when the opinion is devoid of any explanation of how the $3,000 was obtained and on what basis? Why should arguments on appeal which are based on assumptions be considered? Nevertheless, even if the assumption were a sound one, the argument does not offer content to the requirement that the Tax Court's findings be supported by substantial evidence. Is the fact of $1,350 owed to Mr. Showell by Mr. Leech substantial evidence warranting a conclusion by the Tax Court that the "Loss" column figures were unreliable, or is it not substantial evidence, along with the rest of the record, that they *are* reliable?

Next, on page 11, respondent reiterates the Tax Court's reason for acceptance of the "Gain" column figures while rejecting all of the "Loss" column figures on the ground that the former are admissions against interest. This statement does not respond to the contentions made on pages 8 and 9 of petitioners' opening brief

that the phrase "bare 'Loss' figures" was misleading, and that the substance is unsound for the reasons set forth therein. Also, the statement does not supply from the record evidence to support a finding that the "Loss" column figures were unreliable. Therefore, it is submitted that this reason offered by respondent is also deficient in supplying the substantial evidence necessary to support the Tax Court's findings.

Lastly, respondent restates the reasons given by the dissenting judges which were questioned on pages 15 and 16 of petitioners' opening brief. No response to the arguments therein advanced by petitioners is offered. To say that the taxpayer has the burden of proving his deductions is a legal truism in federal income tax law. Stating it in a brief does not supply an answer to the question of whether he carried his burden of proof. Criticism is made of Exhibit 3 as not being sufficient under Section 54 of the Internal Revenue Code of 1939, even though Exhibit 3 was the basis of the Commissioner's deficiencies. But certainly a failure to comply with the requirements of Section 54 does not impose the penalty on a taxpayer of paying a tax on gross income if independent proof is available particularly in a case where the Commissioner has assessed a deficiency based on that same record. Furthermore, it is no answer to petitioners' contentions to say that each case must be decided on the facts. Petitioners do not dispute this. Nobody would. The problem is whether the Tax Court's finding of fact regarding the "Loss" column entries is supported by substantial evidence or even any evidence. So far, it is respectfully suggested that respondent has not offered either substantial evidence or any evidence. The issue is not determined by the last sentence, on page 12 of respondent's brief, that the Tax Court's refusal to accept self-serving testimony was a proper exercise of its prerogative as a trier of fact. There is a great deal more evidence in this record than the testimony of Mr. Showell, assuming that characterizing testimony as "self-serving" is sufficient to avoid the rule set forth in *Grace Bros., Inc.* v. *Commissioner,* 9 Cir., 1949, 173 F.2d 170, 174 quoted on page 10 of petitioners' opening brief.

Petitioners submit that respondent's arguments under I are insufficient.

II

The refusal of the trial judge to receive evidence of disbursements as a necessary part of the testimony relating to petitioners' net worth and disbursements as some proof that additional income was not realized was defended on the ground that this was a reasonable exercise of his discretion. Respondent says there must be a clear abuse of his discretion in ruling on such questions, and cites II Wigmore, Evidence, Section 444; American Law Institute, Model Code of Evidence, Rule 303, along with two cases.

Turning to the cited portion of Wigmore, it is noted that Section 444 refers to the discretion of the trial judge when dealing with proof concerning Tendency, Capacity, Quality, Cause, or Effect. The scope of the subject, says Wigmore, deals with inferences from specific instances of observed effects, exhibitions, or illustrations, to the supposed tendency, capaciy, or quality of producing them. II Wigmore, Evidence, Section 441 at 423. An example given is where the issue is whether the vibrations of factory-machinery have caused a conceded injury in an adjacent house. The main controversy is whether the former is the cause of the latter; but, in searching among the probable causes, the argument is obviously confined to those things which have a tendency or capacity to product such effects, and thus the real proposition of the proponent becomes this: namely, that the factory-apparatus has a tendency or capacity to produce such effects. Petitioners fail to observe the relevance of this type question to net worth and disbursements evidence that income has or has not been realized. Petitioners' counsel doubts that respondent would like the reverse side of the coin if the courts applied the rules of evidence concerning Tendency, Capacity, Quality, Cause, or Effect to net worth cases brought by the Government.

As far as Rule 303 of the Model Code is concerned, and assuming its applicability, it falls within Chapter IV dealing with

admissability as affected by considerations of extrinsic policy, and under Subtitle B entitled Evidence of Comparatively Slight Probative Value. It states that a judge may exclude otherwise admissable evidence if he finds that its probative value is outweighed by the risk that its admission will (a) necessitate undue consumption of time, (b) create substantial danger of undue prejudice or of confusing the issues or misleading the jury, or (c) unfairly surprise a party who had no reasonable ground to anticipate that such evidence would be offered. Petitioners urge that, in view of the majority opinion that *conclusive* proof was necessary and the trial judge's statement indicating proof was impossible, the additional time required to cover Mr. Showell's disbursements would not require an undue consumption of time or create a substantial danger of undue prejudice or confuse the issues or unfairly surprise the defendant to whom a net worth statement was submitted (R. 75). This is especially so after the trial judge admitted all of the net worth testimony.

The two cited cases are equally remote. In *Atlantic Coast Line R. Co.* v. *Pidd,* 197 F.2d 153 (C.A. 5th), certiorari denied, 344 U.S. 874, it was held that in an action against a railroad for damages sustained in a crossing collision between a train and car, evidence *tending* to show speed of train just prior to collision is admissable if not too *remote* in time or distance to be relative, and the admissability is largely in the discretion of the trial court. In *Newman* v. *Clayton F. Summy Co.,* 133 F.2d 465 (C.A. 2nd) it was held that in an action against a music publisher for negligence in failing to return a manuscript submitted to it, the exclusion of testimony of royalties received by the composer from another publisher which also published the composer's reconstructed manuscript on loss of the original was within trial court's discretion in view of the *remoteness* of the testimony.

On page 13 it is argued that the Government's use of the net worth method should be restricted to protect the rights of taxpayers, and that this should be no less true when its use is attempted by a taxpayer to overcome his burden of proof. Petitioners

fail to discern how the rights of the taxpayers are being protected by denying them the use of net worth evidence before a court which is requiring *conclusive* proof and a trial judge whose opinion indicated clearly that the absence of individual bet slips made it impossible to carry their burden of proof, particularly when the court sustained a deficiency based solely on the taxpayer's record (Exhibit 3) while at the same time designating the same record as unreliable.

Next, on page 13 of its brief, respondent contends, as a premise, that:

> "*Traditionally,* it is within the Commissioner's power to determine the correct method for the computation of income . . ." (Emphasis supplied)

and, as a conclusion, that its use should be "sparingly allowed" to taxpayers who have "a *wholly* inadequate record." First, tradition has absolutely nothing to do with the power which the Commissioner does or does not have. His right to use the net worth method is restricted by the language of Section 41 of the Internal Revenue Code of 1939 as interpreted by the Courts. The Commissioner of Internal Revenue has no power founded on tradition. He is an agent of Congress and not of the culture. Also, petitioners ask the Court to note how the respondent constantly refers to Exhibit 3 as "a *wholly* inadequate record" for purposes of denying them the use of net worth and disbursement evidence, but admits that the accuracy of the figures appearing in the "Gain" column of Exhibit 3 were the source of the deficiency notices. When the phrase "*should* be sparingly allowed" is observed, it becomes clear that the contention is a policy argument not based on legal authority, and which does not respond to petitioners' contentions set forth on pages 14 through 17 of their opening brief.

On pages 13 and 14 respondent pleads that the disbursements evidence should have been kept out because the trial might become confusing, burdensome, and long, and the burden on the Commissioner would be "almost insuperable". Petitioners submit that the Commissioner and the Tax Court cannot have it both ways. If

they are going to sustain deficiencies based on the accuracy of Exhibit 3 while denying defenses based on the accuracy of the same piece of paper, petitioners should not be denied the opportunity to disprove the deficiency by other proof. Respondent's agent had seen Mr. Showell's balance sheet, which went into evidence as Exhibit 9 without objection (R. 76). It is difficult to see how respondent would have an insuperable burden when the taxpayers are assigned the burden of proof. Furthermore, the Tax Court itself has permitted the use of net worth and disbursements evidence by a taxpayer against the Government. In *Domenic de Franco,* P-H 1950 T.C. Mem. Dec. Par. 50,311 (1950), the taxpayer offered net worth and disbursements evidence to overcome the Commissioner's determination which was based on gross bank deposits, and in fact the determination based on the net worth and disbursement method was accepted.

Finally respondent says that exclusion of the evidence did not really prejudice petitioners because it was based on Mr. Showell's testimony which was self-serving. If this is the test of admissability of evidence in an income tax case, petitioners suggest that there is not a taxpayer alive who would be able to carry his burden of proof. What is the legal authority for this convenient method of disregarding a portion of a witness' testimony? Petitioners renew the points urged on pages 9 and 10 of the opening brief in this regard. Also, how can respondent conclude it may be disregarded because the Tax Court did not believe his previous testimony? The opinion does not so state nor could it in view of the findings of fact virtually all of which were founded on his testimony.

CONCLUSION

The decisions of the Tax Court should be reversed.

Respectfully submitted,

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November, 1955